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REPORT OF INDEPENDENT AUDITORS

Board of Directors
StarBand Communications Inc.

We have audited the accompanying balance sheet of StarBand Communications Inc. (the "Company"), a development stage enterprise, as of August 31, 2000 and the related statements of operations, mandatorily redeemable convertible preferred stock and stockholders' deficit, and cash flows for the period from January 11, 2000 (inception) through August 31, 2000. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of StarBand Communications Inc., a development stage enterprise, at August 31, 2000 and the results of its operations and its cash flows for the period from January 11, 2000 (inception) through August 31, 2000, in conformity with accounting principles generally accepted in the United States.

/s/ ERNST & YOUNG LLP

McLean, Virginia
October 5, 2000

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STARBAND COMMUNICATIONS INC.
(A Development Stage Enterprise)

BALANCE SHEET

	August 31, 2000	Pro Forma August 31, 2000
		(Unaudited)
ASSETS		
Current assets:		
Cash and cash equivalents	$ 68,302,815	$ 68,302,815
Accounts receivable, net of allowance for doubtful accounts of $82,385	1,285,298	1,285,298
Employee advances	31,556	31,556
Inventory	10,327,075	10,327,075
Deferred customer acquisition costs	1,557,680	1,557,680
Prepaid expenses and other	420,105	420,105
Total current assets	81,924,529	81,924,529
Restricted cash and cash equivalents	90,559,295	90,559,295
Property and equipment, net of accumulated depreciation	13,661,359	13,661,359
Other assets, net of accumulated amortization	10,366,647	10,366,647
Total assets	$ 196,511,830	$ 196,511,830
LIABILITIES, MANDATORILY REDEEMABLE CONVERTIBLE PREFERRED STOCK, AND STOCKHOLDERS' (DEFICIT) EQUITY		
Current liabilities:		
Accounts payable	$ 3,273,282	$ 3,273,282
Accrued expenses and other liabilities	6,631,205	6,631,205
Deferred revenue	1,671,916	1,671,916
Due to Gilat Satellite Networks, Ltd. and Spacenet, Inc.	36,335,390	36,335,390
Due to Microsoft Corporation	1,250,000	1,250,000
Due to EchoStar	50,000	50,000
Due to Employees	110,934	110,934
Total current liabilities	49,322,727	49,322,727
Term loan, net of unamortized discount	81,088,650	81,088,650
Total liabilities	130,411,377	130,411,377
Commitments and contingencies		
Mandatorily redeemable convertible preferred stock:		
Series A, A-1, A-2, B, C, and D mandatorily redeemable convertible preferred stock, $.05 par value; 12% cumulative dividends:		
Series A; 55 million shares authorized; 49,228,259 actual and 0 pro forma shares issued and outstanding, plus accrued dividends	51,494,108	—
Series A-1; 55 million shares authorized; 49,228,259 actual and 0 pro forma shares issued and outstanding, plus accrued dividends	51,526,477	—
Series A-2; 30 million shares authorized; 24,686,284 actual and 0 pro forma shares issued and outstanding, plus accrued dividends	25,838,761	—
Series B; 150 million shares authorized; 140,111,199 actual and 0 pro forma shares issued and outstanding, plus accrued dividends	14,011,120	—
Series C and D; 10 million shares authorized each; 0 shares issued and outstanding	—	—
Total mandatorily redeemable convertible preferred stock	142,870,466	—

	Actual	Pro forma
Stockholders' (deficit) equity:		
Common stock; $.05 par value; 110 million shares authorized; 33,879,757 actual and 88,108,650 pro forma shares issued and outstanding	1,693,988	4,405,433
Additional capital	17,462,758	157,621,779
Deferred compensation	(7,951,674)	(7,951,674)
Deficit accumulated during development stage	(87,975,085)	(87,975,085)
Total stockholders' (deficit) equity	(76,770,013)	66,100,453
Total liabilities, mandatorily redeemable convertible preferred stock and stockholders' (deficit) equity	$ 196,511,830	$ 196,511,830

33,879,757 × 0.05 par
88,108,650 × 0.05 par
$0.56/sh
$1.84/sh

See accompanying notes.

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STARBAND COMMUNICATIONS INC.
(A Development Stage Enterprise)

STATEMENT OF OPERATIONS

	Period from January 11, 2000 (inception) through August 31, 2000
Revenues:	
Internet access	$ 3,264
Customer premises equipment and installation	3,681
Total revenues	6,945
Costs and expenses:	
Network	4,149,048
Customer premises equipment and installation	22,707,245
Sales and marketing	14,822,427
General and administrative (exclusive of non-cash compensation shown below)	25,862,221
Non-cash compensation	300,601
Depreciation	741,962
Total costs and expenses	68,583,504
Loss from operations	(68,576,559)
Non-operating (expense) income:	
Interest expense	(1,564,740)
Interest income	3,292,882
Non-operating income, net	1,728,142

for about 9,000 sites is $2500 per site
very high; shifting G&A expenses to StarBand
$3.4 million vs. 5.6
See discussion of G&A, p. 29

Loss before provision for income taxes		(66,848,417)
Provision for income taxes		—
Net loss		(66,848,417)
Preferred stock dividends and accretion		(15,245,439)
Net loss attributable to common stockholders	$	(82,093,856)
Basic and diluted loss per share	$	(4.06)
Shares used in the calculation of basic and diluted loss per share		20,232,428
Unaudited pro forma net loss attributable to common stockholders	$	(66,848,417)
Unaudited pro forma basic and diluted loss per share	$	(1.23)
Shares used in the calculation of unaudited pro forma basic and diluted loss per share		54,456,199

(3.30) Net loss/sh
(0.75) Preferred dividends

See accompanying notes.

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STARBAND COMMUNICATIONS INC.
(A Development Stage Enterprise)

STATEMENT OF MANDATORILY REDEEMABLE CONVERTIBLE PREFERRED STOCK AND STOCKHOLDERS' DEFICIT

	Common Stock				Deficit Accumulated During Development Stage	Total Stockholders' Deficit
	Shares	Par Value	Additional Capital	Deferred Compensation		
Issuance of Common Stock to founders on January 11, 2000 (inception)	10	$ 1	$ 9	$ —	$ —	$ 10
Issuance of Common Stock to Spacenet, Inc. on April 1, 2000	9,999,989	499,999	(499,999)	—	—	—
Issuance of 140,111,199 shares of mandatorily redeemable convertible Preferred Stock to Spacenet, Inc. on April 1,						

F-5(a)

2000, including accrued dividends of $7,005,560	—	—	(1,124,331)	—	(5,881,229)	(7,005,560)
Issuance of Common Stock at $0.12 per share to EchoStar Communications Corporation on April 11, 2000	6,450,022	322,501	449,240	—	—	771,741
Issuance of 49,228,259 shares of mandatorily redeemable convertible Preferred Stock at $1.00 per share to EchoStar Communications Corporation on April 11, 2000, including accrued dividends of $2,298,218	—	—	—	—	—	—
Issuance of Common Stock at $0.12 per share to ING Furman Selz Investments on April 11, 2000	2,621,960	131,098	182,618	—	—	313,716
Issuance of 24,686,284 shares of mandatorily redeemable convertible Preferred Stock at $1.00 per share to ING Furman Selz Investments on April 11, 2000, including accrued dividends of $1,152,477	—	—	—	—	—	—
Issuance of Common Stock at $0.12 per share to Microsoft G-Holdings, Inc. on April 11, 2000	6,450,022	322,501	449,240	—	—	771,741
Issuance of 49,228,259 shares of mandatorily redeemable convertible Preferred Stock at $1.00 per share to Microsoft G-Holdings, Inc. on April 13, 2000, including accrued dividends of $2,265,849	—	—	—	—	—	—
Issuance of Common Stock at $0.12 per share to other investors on May 3, 2000	8,357,754	417,888	582,112	—	—	1,000,000
Equity issuance costs	—	—	(38,889)	—	—	(38,889)
Issuance of common stock options to employees and non-employee consultants	—	—	7,580,115	(7,580,115)	—	—
Issuance of warrants to non-employee consultants	—	—	672,160	(672,160)	—	—
Amortization of deferred compensation	—	—	—	300,601	—	300,601
Issuance of warrants in connection with the term loan	—	—	9,210,483	—	—	9,210,483
Net loss for the period						

F-5 (6)

from January 11, 2000 (inception) to August 31, 2000	—	—	—	—	(66,848,417)	(66,848,417)
Preferred stock dividends and accretion	—	—	—	—	(15,245,439)	(15,245,439)
Balance at August 31, 2000	33,879,757	$1,693,988	$17,462,758	$ (7,951,674)	$(87,975,085)	$(76,770,013)

[Additional columns below]

[Continued from above table, first column(s) repeated]

	Mandatorily Redeemable Convertible Preferred Stock
Issuance of Common Stock to founders on January 11, 2000 (inception)	$ —
Issuance of Common Stock to Spacenet, Inc. on April 1, 2000	—
Issuance of 140,111,199 shares of mandatorily redeemable convertible Preferred Stock to Spacenet, Inc. on April 1, 2000, including accrued dividends of $7,005,560	14,011,120
Issuance of Common Stock at $0.12 per share to EchoStar Communications Corporation on April 11, 2000	—
Issuance of 49,228,259 shares of mandatorily redeemable convertible Preferred Stock at $1.00 per share to EchoStar Communications Corporation on April 11, 2000, including accrued dividends of $2,298,218	51,526,477
Issuance of Common Stock at $0.12 per share to ING Furman Selz Investments on April 11, 2000	—
Issuance of 24,686,284 shares of mandatorily redeemable convertible Preferred Stock at $1.00 per share to ING Furman Selz Investments on April 11, 2000, including accrued	

dividends of $1,152,477	25,838,761
Issuance of Common Stock at $0.12 per share to Microsoft G-Holdings, Inc. on April 11, 2000	—
Issuance of 49,228,259 shares of mandatorily redeemable convertible Preferred Stock at $1.00 per share to Microsoft G-Holdings, Inc. on April 13, 2000, including accrued dividends of $2,265,849	51,494,108
Issuance of Common Stock at $0.12 per share to other investors on May 3, 2000	—
Equity issuance costs	—
Issuance of common stock options to employees and non-employee consultants	—
Issuance of warrants to non-employee consultants	—
Amortization of deferred compensation	—
Issuance of warrants in connection with the term loan	—
Net loss for the period from January 11, 2000 (inception) to August 31, 2000	—
Preferred stock dividends and accretion	—
Balance at August 31, 2000	$142,870,466

See accompanying notes.

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STARBAND COMMUNICATIONS INC.
(A Development Stage Enterprise)

STATEMENT OF CASH FLOWS

	Period from January 11, 2000 (inception) through August 31, 2000
Operating activities:	
Net loss	$ (66,848,417)
Adjustments to reconcile net loss to net cash used in operating activities:	
Amortization of deferred compensation	300,601
Depreciation	741,962
Provision for bad debts	82,385
Interest earned on restricted cash and cash equivalents	(959,295)
Amortization of debt discount and issuance costs	374,413
Changes in operating assets and liabilities:	
Accounts receivable	(1,367,683)
Employee advances	(31,556)
Inventory	(10,327,075)
Deferred customer acquisition costs	(1,557,680)
Prepaid expenses and other	(420,105)
Accounts payable	2,696,449
Accrued expenses and other liabilities	6,631,205
Deferred revenue	1,671,916
Due to Gilat Satellite Networks, Ltd. and Spacenet, Inc.	20,695,971
Due to EchoStar	50,000
Due to Employees	110,934
Net cash used in operating activities	(48,155,975)
Investing activities:	
Increase in restricted cash and cash equivalents	(89,600,000)
Purchases of property and equipment	(9,541,220)
Net cash used in investing activities	(99,141,220)
Financing activities:	
Proceeds from issuance of Common Stock	2,857,208
Proceeds from issuance of Preferred Stock	123,142,802
Proceeds from issuance of term loan, net of debt issuance costs totaling $400,000	89,600,000
Net cash provided by financing activities	215,600,010
Net increase in cash	68,302,815
Cash at beginning of period	—
Cash at end of period	$ 68,302,815

See accompanying notes.

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STARBAND COMMUNICATIONS INC.
(A Development Stage Enterprise)

NOTES TO FINANCIAL STATEMENTS

1. Organization and Business Activities

Principal Business

StarBand Communications Inc. (the "Company" or "StarBand"), formerly known as Gilat-to-Home, Inc., provides two-way, always-on, high-speed Internet access to residential and small office/ home office customers available virtually everywhere in North America via satellite. The StarBand network provides high-capacity, high-speed transmission of data, audio, and video. The Company offers stand-alone Internet access as well as a bundled product with a direct broadcast satellite ("DBS") subscription television service. The Company is in the development stage and has not commenced full operations at August 31, 2000. The Company believes that it operates in one operating segment.

Organization and Formation

The Company, a Delaware corporation located in McLean, Virginia, was founded on January 11, 2000 by Spacenet, Inc. ("Spacenet"), a wholly owned subsidiary of Gilat Satellite Networks ("Gilat"). On February 15, 2000, Microsoft Corporation ("Microsoft"), through its wholly owned subsidiary Microsoft G-Holdings, Inc., entered into certain investment and operating agreements with the Company. On March 30, 2000, EchoStar Communications Corporation ("EchoStar") entered into certain investment and operating agreements with the Company and ING Furman Selz Investments ("ING") entered into an investment agreement with the Company. Contemporaneously with the investment agreements, the Company entered into certain supply and operating agreements with Gilat, Spacenet, Microsoft, and EchoStar that provide the Company with access to consumer brand names, proprietary technology, retail distribution and supply channels, as more fully described in Note 3.

The network and related technology utilized by the Company to provide Internet access service was developed by Gilat, a provider of satellite-based networks. On April 1, 2000, Gilat, through Spacenet, contributed to the Company the exclusive North American rights for its high-speed satellite Internet service for an initial term of five years, for use in the residential and small office/ home office market segments, as well as management, employees and technological expertise, including the operation of corporate satellite networks, in exchange for mandatorily redeemable convertible Series B convertible preferred stock and Common Stock. Pursuant to Staff Accounting Bulletin No. 48, *Valuation of Assets Acquired From Promoters and Stockholders,* the Company recorded this transfer at Gilat's historical cost basis of $0.

The Company provides transmission-only Internet services and second-level help desk services to Microsoft. Microsoft markets an MSN-branded high speed access service through direct customer solicitation, a RadioShack retail distribution network alliance, and other retail organizations. The Company's satellite based service enables Microsoft to deliver multimedia content and e-commerce services to its subscribers. Microsoft invested $50 million on April 13, 2000 in exchange for mandatorily redeemable convertible Series A Preferred Stock and the

Company's Common Stock, par value $0.05 (the "Common Stock").

The Company offers its service on both a stand alone basis and bundled with DISH Network's DBS service. EchoStar is also an international supplier of digital satellite receivers and a provider of other satellite services. EchoStar invested $50 million on April 11, 2000 in exchange for mandatorily redeemable convertible Series A-1 Preferred Stock and Common Stock.

ING invested $25 million on April 11, 2000 in exchange for mandatorily redeemable convertible Series A-2 Preferred Stock and Common Stock. In addition, certain other parties affiliated with Gilat invested $1 million on May 3, 2000 in exchange for Common Stock.

STARBAND COMMUNICATIONS INC.
(A Development Stage Enterprise)

NOTES TO FINANCIAL STATEMENTS — (Continued)

Significant Risk and Uncertainties

The Company is in the development stage during which time it has generated negative cash flows from operations and a net loss. The Company expects negative cash flows from operations and net losses to continue as it builds its subscriber base. The ability to generate positive cash flow from operations in the future is dependent upon many factors, including general economic conditions, the level of market acceptance for the Company's services, and the degree of competition encountered by the Company. Additional funding may be required to develop operations; however, there can be no assurance when or if future operations of the Company will be successful or that further financing will be available with terms acceptable to the Company, or at all.

2. Summary of Significant Accounting Policies

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates.

Cash and Cash Equivalents

The Company considers all highly liquid investments with a maturity of three months or less at the time of purchase to be cash equivalents except for restricted cash and cash equivalents,

Inventory

Inventory primarily consists of uninstalled customer premises equipment ("CPE"), including personal computers, satellite modem cards, and dish antenna units and is stated at the lower of cost or market value. Substantially all of the Company's inventory represents finished goods. Cost is determined using the moving weighted-average cost method.

Restricted Cash and Cash Equivalents

A lending institution holds restricted cash and cash equivalents in connection with the $90 million term loan, as more fully described in Note 7. The funds are available to the Company pursuant to specific approval by the lenders' agent after the Company has exhausted all equity funds raised.

Property and Equipment

Property and equipment includes computers and electronic equipment, office furniture and equipment, and leasehold improvements and are stated at historical cost. The costs of additions and leasehold improvements are capitalized, while maintenance and repairs are expensed as incurred. Property and equipment are depreciated using the straight-line method over estimated useful lives of three to seven years. Leasehold improvements are amortized over the shorter of the lease term or the estimated useful life of the asset.

Internal Use Software

The Company follows the provisions of Statement of Position 98-1, *Accounting for the Costs of Computer Software Developed or Obtained for Internal Use* ("SOP 98-1") that requires the capitalization and amortization of certain costs incurred in connection with developing or obtaining internal use software.

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The Company capitalized approximately $4.1 million related to internal use software that is being amortized over three years. Accumulated amortization was approximately $0.4 million at August 31, 2000.

Impairment of Long Lived Assets

The Company assesses the impairment of long-lived assets, including intangible assets, in accordance with Statement of Financial Accounting Standards No. 121, *Accounting for the Impairment of Long Lived Assets and for Long Lived Assets to be Disposed of* ("SFAS No. 121").

SFAS No. 121 requires impairment losses to be recognized for long-lived assets when indicators of impairment are present and the undiscounted cash flows are not sufficient to recover the assets' carrying amounts. Intangibles are also evaluated for recoverability by estimating the projected undiscounted cash flows, excluding interest, of the related business activities. The impairment loss of these assets is measured by comparing the carrying amount of the asset to its fair value less disposal costs with any excess of carrying value over fair value written off. Fair value is based on market prices where available, an estimate of market value, or various valuation techniques including discounted cash flow.

Financial Instruments

The carrying value of the Company's financial instruments including cash and cash equivalents, accounts receivable, restricted cash and cash equivalents, accounts payable, accrued expenses and other liabilities, and term loan approximate fair value. Management estimates that the carrying value of the Company's Series A, Series A-1, Series A-2, and Series B mandatorily redeemable convertible Preferred Stock approximates fair value at August 31, 2000.

Concentrations of Credit Risk

Financial instruments that potentially subject the Company to concentrations of credit risk consist primarily of cash and cash equivalents and restricted cash and cash equivalents. The Company deposits its cash and cash equivalents and restricted cash and cash equivalents with high credit quality financial institutions.

Revenue and Expense Recognition

The Company's revenues are derived from fees from customers for Internet access and the related sale and installation of CPE necessary to provide such access. These services are primarily distributed through joint marketing agreements with Microsoft through its MSN Internet portal and independent retail distribution network, EchoStar through its direct broadcast satellite and independent dealer networks, and, to a lesser extent, through internally generated customers. Substantially all customers execute subscription agreements with either the Company or Microsoft specifying the term of the agreement, fees payable, if any, for monthly Internet access, CPE necessary to receive the Internet access service, and installation services. Revenue derived from services offered to subscribers through the MSN network are billed to and collected from Microsoft. The Company does not have direct billing responsibilities or collection risk for each subscriber serviced through the MSN network. The Company does have billing responsibilities and collection risk related to each subscriber executing a subscription agreement through the EchoStar network or internally generated customer.

The Company considers the sale and installation of CPE and the Internet access to be a multi-element, single arrangement with the subscriber. Total revenue from the arrangement is recognized as earned on a straight-line basis over the service period that is defined as the lesser of the contractual term of the subscription agreement or expected life of the subscriber. The Company normally commences the recognition of revenue upon activation of the Internet access. Accordingly, revenue and costs of CPE sold

STARBAND COMMUNICATIONS INC.
(A Development Stage Enterprise)

NOTES TO FINANCIAL STATEMENTS — (Continued)

are deferred until customer service agreements are entered into and the CPE is installed and access is provided and is then recognized over the service period as defined above. Certain service agreements include clauses whereby the subscriber has the right to cancel the service without substantial penalty during the initial service period. Revenue attributable to service agreements containing cancellation clauses is deferred and recognized on a straight-line basis over the service period remaining subsequent to risk free cancellation period.

The costs of the CPE and installation are generally capitalized and recognized as cost of sales on a straight-line basis over the service period. However, through August 31, 2000, such costs have been expensed to the extent they exceed deferred access revenue because realization of future cash flows in amounts sufficient to ensure recoverability of such costs is not assured. During the development stage, the Company ran a pilot program in which a significant number of subscribers received CPE at no charge.

Other subscriber acquisition costs, which consist principally of commissions payable to the Company's distribution channels, are expensed as incurred.

Sources of Supplies

The Company currently leases transponder space from two third-party suppliers. These contracts generally provide the Company with non-preemptible transponder service; however, they may not provide for alternative service in the event of an anomaly or failure. Management believes alternative satellite capacity can be found if such events occur. The Company also relies on Gilat and Spacenet for a majority of the technology necessary to operate the network, including certain CPE as well as research and development activities, as more fully described in Note 3. Any disruption of these services could have a material adverse effect on the Company's operating results.

Significant Customers and Suppliers

Substantially all inventory was purchased from its three largest suppliers, including Gilat, during the period from January 11, 2000 (inception) through August 31, 2000.

Advertising Costs

All advertising and promotion costs are expensed as incurred. The Company considers all direct mail, telephone, print, video, audio, and similar costs associated with solicitation of new subscribers and brand awareness as advertising costs. The Company expensed approximately $14.8 million as advertising and promotion costs during the period from January 11, 2000 (inception) through August 31, 2000.

Research and Development Costs

Research and development costs are expensed as incurred. Research and development costs were approximately $1.7 million during the period from January 11, 2000 (inception) through August 31, 2000.

Stock Based Compensation

In October 1995, the Financial Accounting Standards Board issued Statement of Financial Accounting Standard No. 123, "Accounting for Stock-Based Compensation" ("SFAS No. 123"). SFAS No. 123 allows companies to account for stock-based compensation under the provisions of SFAS No. 123 or under the provisions of Accounting Principles Board Opinion No. 25 ("APB No. 25"), but requires pro forma disclosures in the footnotes to the financial statements as if the measurement provisions of SFAS No. 123 had been adopted. The Company accounts for its stock-based compensation in accordance with APB No. 25.

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Basic and Diluted Loss per Share

Basic and diluted loss per share is calculated by dividing the net loss attributable to common stockholders by the weighted average number of shares of common stock outstanding during the period. Convertible preferred stock, stock options, warrants, and other potentially dilutive securities have been excluded from the calculation of diluted loss per share for all periods the Company reports a net loss since their effect is anti-dilutive.

The weighted average number of shares of common stock used in the calculation of pro forma basic and diluted loss per share assumes the mandatorily redeemable convertible preferred stock plus accrued dividends were converted to common stock on the actual issuance date of the related preferred stock. Mandatorily redeemable Series C and D Preferred Stock are not included in the pro forma basic and diluted weighted average number of shares because its issuance and conversion to common stock is not dependent upon an initial public offering.

Statement of Cash Flows

Non-cash investing and financing activities and supplemental cash flow information includes the acquisition of property and equipment financed by accounts payable and due to Gilat of approximately $4.9 million and the issuance of mandatorily redeemable convertible Series B Preferred Stock and Common Stock to Spacenet in exchange for intellectual property rights and non-compete agreements, as more fully described in Note 3. The Company also issued warrants in connection with the term loan, as more fully described in Notes 7 and 9. In addition, the Company recognized 12% cumulative dividends and accretion attributable to its convertible Series A, A-1, A-2, and B Preferred Stock.

Recent Pronouncements

In December 1999, the Securities and Exchange Commission released Staff Accounting Bulletin No. 101, *Revenue Recognition in Financial Statements* ("SAB No. 101"). SAB No. 101 is effective in the fiscal quarter commencing October 1, 2000 and provides clarification with regard to existing authoritative guidance with regard to the manner and timing under which revenue is recognized. The Company elected to adopt the guidance provided by SAB No. 101 effective with its commencement of operations. Future interpretations of SAB No. 101 will be evaluated upon issuance and are not expected to have a material effect on future operations.

On March 16, 2000, the Emerging Issues Task Force issued EITF 99-19, *Recording Revenue Gross as a Principal versus Net as an Agent.* The EITF discusses various indicators that a company would use in determining whether to record revenue on a gross versus net basis. The Company considered these indicators in developing its revenue recognition policies.

SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities" requires companies to record derivatives on the balance sheet as assets or liabilities, measured at fair market value. Gains or losses resulting from changes in the values of those derivatives are accounted for depending on the use of the derivative and whether it qualifies for hedge accounting. The key criterion for hedge accounting is that the hedging relationship must be highly effective in achieving offsetting changes in fair value or cash flows. SFAS No. 133 is effective for fiscal years beginning after June 15, 2000. The Company believes the adoption of SFAS No. 133 will not have a material effect on the financial statements.

STARBAND COMMUNICATIONS INC.
(A Development Stage Enterprise)

NOTES TO FINANCIAL STATEMENTS — (Continued)

3. Related Party Transactions

Broadband Access Services Supply Agreement

The Company entered into a Broadband Access Services Supply Agreement ("Supply Agreement") with Gilat, Spacenet, and Microsoft on February 15, 2000 whereby the Company will provide broadband access via satellite to and from the Microsoft MSN Portal and the Internet for use by Microsoft customers in North America with a term of four years. The agreement renews automatically for additional one-year terms unless terminated by either the Company or MSN. The agreement requires the Company to achieve five milestones during the initial term relating primarily to the Company fulfilling production levels for StarBand modems, achieving minimum levels of MSN subscribers and other technical matters set forth in the agreement. MSN's commitment to the agreement is contingent upon the Company meeting these milestones. To date, the Company has not completed any of the milestones set forth in this agreement. Upon completion of the milestones, MSN will purchase StarBand modem-based systems in predetermined quantities and at predetermined prices for use as part of a high-speed Internet access offering by MSN. The Company will supply MSN with StarBand modems in accordance with a specified production schedule. MSN will provide a subsidy for a portion of the cost of the customer premises equipment for MSN subscribers. Pursuant to this agreement, the Company agreed to pay MSN a one time fee of $1.25 million to offset a portion of MSN's subscriber acquisition costs. Such amount was accrued at August 31, 2000 and will reduce revenues as MSN provides the CPE subsidies.

The agreement also sets the monthly per subscriber fee the Company will collect from MSN, and the minimum monthly fees that MSN will collect from its subscribers. The Company also granted MSN most favored customer status and agreed, for a limited time, to refrain from providing its service to a number of Internet service providers.

In March 2000, Gilat entered into a performance guarantee agreement pursuant to which Gilat unconditionally and irrevocably guaranteed to MSN the Company's compliance with various material obligations under the Supply Agreement and related operative agreements.

The parties have also agreed to certain non-compete arrangements for specific periods of time limiting the counter-parties ability to enter into similar arrangements with each other competitors. Microsoft will also provide marketing to its current customers with no reimbursements from the Company pursuant to the Supply Agreement.

The Company made no payments to and received no payments from Microsoft attributable to the Supply Agreement during the period from January 11, 2000 (inception) through August 31, 2000.

Gilat Supply Agreements

The Company entered into a five year supply agreement with Gilat, Spacenet, and Microsoft on February 15, 2000 ("Gilat Supply Agreement"). The Gilat Supply Agreement sets forth the commercial terms under which the Company offers StarBand service outside the Company's arrangement with MSN, and the terms under which Gilat and Spacenet provide the Company with licenses, intellectual property and satellite capacity on the GE Americom GE4 satellite for that purpose. In addition, Spacenet and Gilat have agreed not to offer services that compete with the Company's service to residential and small office/home office customers throughout North America.

Pursuant to this agreement, the Company assumed Spacenet's monthly payment obligations for the GE4 satellite capacity and accrued $7.2 million due to Spacenet as reimbursement for a $7.2 million payment made by Spacenet to reserve the GE4 satellite capacity.

STARBAND COMMUNICATIONS INC.
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NOTES TO FINANCIAL STATEMENTS — (Continued)

In addition, Gilat and Spacenet are required to provide certain services, network equipment and hubs, and CPE at fixed prices through the term of the Gilat Supply Agreement. Gilat is also required to provide all additional research and development necessary to create the next generation of CPE units. The terms of these commitments will be covered by the Master Supply and Services Agreement discussed below. In addition, Gilat provided certain performance guarantees to Microsoft and EchoStar. This agreement terminates upon termination of the Supply Agreement.

Telecommunication Services Agreement

The Company entered into a one-year telecommunications services agreement with Spacenet dated February 15, 2000, which is renewable for up to four years at the option of Microsoft. MSN is the third-party beneficiary of this agreement. Under this agreement, Spacenet provides and operates telecommunications facilities and services, including access to Spacenet's transmission and switching facilities, which the Company needs to fulfill its obligations to MSN. The Company is obligated to reimburse Spacenet for actual direct costs, including employee costs, without mark-up or profit pursuant to the Services Agreement. In exchange for these technologies, and certain other rights, the Company issued 9,999,989 shares of its common stock and 140,111,199 shares of its Series B convertible preferred stock to Spacenet.

The Company incurred approximately $95.0 million of reimbursable expenses and capital expenditures attributable to the Gilat Supply Agreements and the Telecommunications Services Agreement and paid approximately $20.0 million to Gilat and $38.7 million to Spacenet attributable to operations pursuant to these Agreements during the period from January 11, 2000 (inception) through August 31, 2000. The Company has accrued the remaining $36.3 million as due to Gilat and Spacenet at August 31, 2000.

Master Supply and Services Agreement

The Company expects to enter into a four-year master supply and services agreement with Gilat and Spacenet that will replace the existing Gilat Supply Agreements. This agreement will automatically renew for two-year periods unless terminated by any party. Pricing terms, however, will be renegotiated every two years. Under this agreement, Gilat and Spacenet will provide the Company with the equipment, software and services needed in its business, including: customer premises equipment, network operations equipment, software necessary for the network to operate, and the multicast system; and consulting and administrative services, including information technology, marketing, financial, and legal services for a transition period until the Company establishes its own systems and processes. The Company expects the total cost to be approximately $2.1 million per calendar quarter, which the Company believes approximates the fair value for such services.

Gilat will also provide research and development support in connection with hardware, equipment and software maintenance that arises out of this agreement. During the first two years of the agreement, the Company will pay Gilat $1.0 million per calendar quarter to assist with basic ongoing research and development expenses which the Company believes approximates fair value for such services. Beginning in 2001, the Company will share with Gilat product development costs focused exclusively on reducing the cost to manufacture the next-generation StarBand modem.

The Company will purchase most of the equipment and services necessary for its business exclusively from Gilat and Spacenet, who have granted the Company an exclusive license to use the technology required to provide the service to customers in the United States and Canada. The Company will pay Gilat various one-time fees in connection with its assistance in the preparation of our business plan, product plan, and training program which is expected to be on a cost reimbursement basis.

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Spacenet granted the Company a sublicense to use its enterprise resource planning system and the software for the Company to perform back-office functions. In the future, the Company will provide Spacenet with equipment and services that Spacenet may then re-sell to various enterprise and small office/home office non-residential customers, subject to Spacenet's recognition of the Company's exclusive marketing rights and compliance with the Company's guidelines.

Memorandum of Agreement

The Company, Gilat and EchoStar entered into a memorandum of agreement on February 22, 2000 setting forth the terms under which the Company will jointly market its high-speed Internet access service with EchoStar's DISH DBS television service. The agreement with EchoStar expires on March 31, 2001. EchoStar will market the Company's service directly to their customers and through their DISH retailers. In exchange, the Company agreed to market DISH's satellite television programming service together with its high-speed Internet access service. EchoStar has made no commitments and is subject to no penalties if it ceases to sell the Company's services. EchoStar and Gilat are also currently conducting research and development of a product to provide the Company's Internet service through a TV-centric platform in the future.

Under the terms of this memorandum of agreement, the Company will pay EchoStar activation fees and residual commissions for each StarBand subscriber the Company acquires through the DISH retail sales channel. The Company will provide all customer premises equipment and EchoStar will provide the initial point of contact for service calls. DISH Network Service Corporation, an EchoStar affiliate, will install the equipment and EchoStar will split any associated costs of such installation with the Company. The Company will pay incentive fees to EchoStar's independent installers and DISH retailers who sell its equipment. The Company will also market

EchoStar's DISH direct broadcast satellite television services to StarBand subscribers not acquired through EchoStar for which EchoStar will pay the Company commissions. This memorandum of agreement contains provisions which restrict the Company and EchoStar from entering into co-marketing relationships with competitors of each other for a limited time.

The Company shipped approximately $1 million of CPE to EchoStar pursuant to this memorandum of agreement during the period from January 11, 2000 (inception) through August 31, 2000. The Company had a net receivable of approximately $1 million from EchoStar at August 31, 2000.

4. Accounts Receivable

The Company's accounts receivable consist of amounts due from subscribers and its distribution alliance partners attributable to CPE, installations, and monthly access fees as follows:

	August 31, 2000
Due from EchoStar — CPE	$ 1,028,439
Other CPE	154,871
Installation services	59,373
Other	125,000
	1,367,683
Allowance for doubtful accounts	(82,385)
Total	$ 1,285,298

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The Company provides an allowance for accounts receivable amounts deemed uncollectible as determined by management. Activity in the allowance for doubtful accounts was as follows:

	Period from January 11, 2000 (inception) through August 31, 2000
Beginning balance	$ —
Charge-offs	—
Provision for bad debts	82,385
Ending balance	$ 82,385

5. Property and Equipment

Property and equipment consist of the following:

	August 31, 2000
Computers and electronic equipment	$ 1,041,548
Machinery and equipment	5,380,767
Furniture, fixtures, and office equipment	648,072
Software	4,121,740
Leasehold improvements	3,211,194
	14,403,321
Less: accumulated depreciation	(741,962)
Net property and equipment	$ 13,661,359

Repairs and maintenance costs were approximately $66,288 during the period from January 11, 2000 (inception) to August 31, 2000.

6. Other Assets

Other assets include a lease reservation fee of $7.2 million, CPE subsidies advanced to Microsoft of $1.25 million, and debt issuance costs aggregating $1,991,934 less accumulated amortization of $75,287 at August 31, 2000. Lease reservation fees for satellite transponder capacity are amortized on a straight-line basis over the shorter of the life of the lease or upon forfeiture of transponder space. The CPE subsidies advanced to Microsoft will be amortized on a dollar for dollar basis as the subsidies are paid to the Company from Microsoft for such equipment. The debt issuance costs are amortized over the period of the term loan as an additional component of interest expense using the effective interest method.

7. Term Loan

The Company entered into a senior debt facility on June 26, 2000 with Bank Leumi USA, as agent and lender, under which Bank Leumi USA made a term loan to us in principal amount of $90 million. The senior debt facility was amended on September 8, 2000, when the First International Bank of Israel and the Israel Discount Bank Ltd. joined the agreement as additional lenders and provided loans of $30 million each, bringing the total amount of financing to

$150 million. All outstanding amounts are currently held in interest-bearing accounts. All proceeds raised in the Company's equity placements with Microsoft, EchoStar, ING Furman Selz Investments and the other investors must be expanded to fund our business operations prior to the proceeds from the senior debt facility being available to the Company to

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fund operations or capital expenditures. The initial minimum draw of term loan proceeds is $5 million and $1 million increments in excess thereof. The Company has also entered into ancillary security agreements with the lenders to provide them with collateral for the loan. Under the security agreements, the Company has granted to Bank Leumi USA, as agent for the lenders, a security interest in substantially all of its assets, except for its contractual rights to receive capacity and other services under its transponder lease agreements. The term loan will become due and payable on June 26, 2003, with interest payable quarterly in arrears. As of August 31, 2000, the entire loan amount of $90 million was bearing interest at LIBOR plus 0.75% (7.5625% at August 31, 2000). The interest rate will rise to LIBOR plus 1.5% after June 26, 2002. Subject to certain conditions, the Company is permitted to convert the LIBOR loan to a base rate loan, which would bear interest at the higher of the prime rate and the Federal Funds Rate plus 0.5% (10.0% at August 31, 2000). The Company may prepay the term loan, in whole or in part, without premium or penalty after June 26, 2001. In the event the Company receives an aggregate amount of proceeds in excess of $50 million in a public offering of capital stock or at least $10 million in insurance proceeds or from the sale of any asset, the Company is required to prepay the term loan.

In connection with the term loan, the Company also issued each of the lenders warrants to purchase its Series C convertible preferred stock and a right to acquire Series D convertible preferred stock in exchange for $10 million of the principal amount of the loan. This right to acquire Series D preferred stock expired on September 9, 2000. If the Series C convertible preferred shares were converted into common stock prior to June 26, 2002, the lenders would own in the aggregate approximately 2% of the Company's fully diluted common stock. If the Series C convertible preferred shares were converted into common stock after August 7, 2002, the lenders would own in the aggregate approximately 2.25% of the Company's fully diluted common stock. The Series C convertible preferred stock warrants were estimated to have a fair value of $9.2 million and was recorded as an original issuance debt discount and is being amortized over the period of the term loan as a component of interest expense. As of August 31, 2000, if the Series C convertible preferred stock was converted into common stock, the lenders would own, in the aggregate, approximately 1,873,477 shares.

As a condition of the term loan, the Company is required to provide financial reports and other information to the lenders and maintain insurance, and is not permitted to incur additional bank loans and certain other types of indebtedness. The Company is also not permitted to exceed stated limits on aggregate capital expenditures without the prior written consent of the lenders.

Events of default include non-payment, breach of obligation, misrepresentation, invalidity or illegality of documents, insolvency or insolvency proceedings, change of control, and breach or termination of material contracts.

The Company's Series C and D convertible preferred stock is more fully described in Note 9.

8. Income Taxes

The Company accounts for taxes under Statement of Financial Accounting Standards No. 109, *Accounting for Income Taxes* (SFAS No. 109). Under SFAS No. 109, deferred tax liabilities and assets are determined based on the difference between the financial statement and tax basis of assets and liabilities using enacted rates expected to be in effect during the year in which the differences reverse.

The difference between amounts computed by applying the statutory federal income tax rates to the net loss and total income tax benefit were as follows:

	Period from January 11, 2000 (inception) through August 31, 2000
Federal tax benefit at statutory rates	$ (23,396,946)
State income taxes, net of federal benefit	(2,607,088)
Change in valuation allowance	26,004,034
	$ —

Deferred income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting and the amounts for income tax purposes. The significant components of the deferred tax asset is as follows:

	August 31, 2000
Net operating loss carryforwards	$ 26,004,034
Less valuation allowance	(26,004,034)
Net deferred tax assets	$ —

The Company had net operating losses of approximately $66.8 million at August 31, 2000. The timing and manner in which the operating loss carryforward may be utilized by the Company will be limited to the Company's ability to generate future taxable income. Current net operating loss carryforwards will begin expiring in 2021. As the Company has not generated earnings and no assurance can be made of future earnings needed to utilize these net operating losses, a valuation allowance in the amount of the deferred tax asset has been recorded.

The Company paid no income taxes during the period from January 11, 2000 (inception) through August 31, 2000.

9. Preferred Stock

On April 1, 2000, the Company issued 140,111,199 shares of its mandatorily redeemable convertible Series B Preferred Stock ("Series B Preferred") to Spacenet in exchange for certain assets, intellectual property rights and licenses. Pursuant to Staff Accounting Bulletin No. 48, *Valuation of Assets Acquired From Promoters and Shareholders,* the Company recorded the transfer at Gilat's historical cost basis of $0. The Series B Preferred is convertible into common shares at 5:1 at the election of the holder and automatically converts upon consummation of an initial public offering. The Series B Preferred has no voting rights other than matters subject to shareholder votes that would dilute or reduce the rights or privileges of the Series B Preferred. Dividends accrue at 12% per annum on a cumulative basis and are payable in additional shares of Series B Preferred. In addition, the holder of the Series B Preferred has liquidation preferences in the event of a dissolution or similar termination of the Company equal to $1.00 per share of Series B Preferred plus any accrued and unpaid dividends. The Series B Preferred holder has the right to require the Company to repurchase such shares if an Event of Default, as defined, occurs and is continuing subsequent to notice of such default. This mandatory redemption right is payable in cash, at $1.00 per share of Series B Preferred plus any accrued and unpaid dividends and expires upon consummation of an initial public offering of the Company's common stock with gross proceeds to the

Company of at least $40 million. As of August 31, 2000, the redemption value of the Series B Preferred was approximately $147 million.

On April 13, 2000, the Company sold 49,228,259 shares of its mandatorily redeemable convertible Series A Preferred Stock ("Series A Preferred") to Microsoft and affiliates for $1.00 per share. The Series A Preferred is convertible into common shares at 5:1 at the election of the holder and automatically converts upon consummation of an initial public offering. The Series A Preferred has no voting rights other than matters subject to shareholder votes that would dilute or reduce the rights or privileges of the Series A Preferred. Dividends accrue at 12% per annum on a cumulative basis and are payable in additional shares of Series A Preferred. In addition, holder of the Series A Preferred has a liquidation preference in the event of a dissolution or similar termination of the Company equal to $1.00 per share of Series A Preferred plus any accrued and unpaid dividends. The Series A Preferred holder has the right to require the Company to repurchase such shares if an Event of Default, as defined, occurs and is continuing subsequent to notice of such default. This mandatory redemption right is payable in cash, at $1.00 per share of Series A Preferred plus any accrued and unpaid dividends and expires upon consummation of an initial public offering of the Company's common stock with gross proceeds to the Company of at least $40 million. In the event the Series A Preferred holder receives a valuation of the Company equal to or in excess of $2 billion by a nationally recognized investment bank, the holder has the right to require the Company to repurchase 100% of the Series A Preferred and any common stock held at its fully diluted pro rata portion of such valuation. This valuation put expires upon consummation of an initial public offering of the Company's common stock with gross proceeds to the Company of at least $40 million. In the event the Company has not consummated an initial public offering of its common stock prior to February 1, 2003, the Series A Preferred holder has the right to require the Company to repurchase 50% of the Series A Preferred and any common stock held on such date, 35% of the Series A Preferred and Common Stock held 12 months thereafter, and 15% of the Series A Preferred and common stock held on February 1, 2005 at an independently appraised fair value of the shares on such date as determined by a nationally recognized investment bank. In addition, upon breach by the Company, Spacenet, or Gilat under the Supply Agreement, Gilat Supply Agreement, or the Services Agreement, the holder has the right to require the Company to repurchase 100% of the Series A Preferred and any Common Stock held at fair market value based on the closing market price of such securities or independent appraisal by a nationally recognized investment bank. In August 2000, the Company, Microsoft and Spacenet entered into an agreement whereby these redemption obligations were assigned from the Company to Spacenet and Spacenet accepted such assignment. As the Articles of Incorporation related to the Series A Preferred contain redemption obligations if an Event of Default occurs, the Series A Preferred is classified with the mandatorily redeemable convertible preferred stock. The redemption value of the Series A Preferred is approximately $51.5 million at August 31, 2000.

On April 11, 2000, the Company sold 49,228,259 shares of its mandatorily redeemable convertible Series A-1 Preferred Stock ("Series A-1 Preferred") to EchoStar for $1.00 per share. The Series A-1 Preferred is convertible into common shares at 5:1 at the election of the holder and automatically converts upon consummation of an initial public offering. The Series A-1 Preferred has no voting rights other than matters subject to shareholder votes that would dilute or reduce the rights or privileges of the Series A-1 Preferred. Dividends accrue at 12% per annum on a cumulative basis and are payable in additional shares of Series A-1 Preferred. In addition, holder of the Series A-1 Preferred has a liquidation preference in the event of a dissolution or similar termination of the Company equal to $1.00 per share of Series A-1 Preferred plus any accrued and unpaid dividends. The Series A-1 Preferred holder has the right to require the Company to repurchase such shares if an Event of Default, as defined, occurs and is continuing subsequent to notice of such default. This mandatory redemption right is to be settled, in cash, at $1.00 per share of Series A-1 Preferred plus any accrued and unpaid dividends and expires upon consummation

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of an initial public offering of the Company's common stock with gross proceeds to the Company of at least $40 million. The redemption value of the Series A-1 Preferred is approximately $51.5 million at August 31, 2000.

On April 11, 2000, the Company sold 24,686,284 shares of its mandatorily redeemable convertible Series A-2 Preferred Stock ("Series A-2 Preferred") to ING for $1.00 per share. The Series A-2 Preferred is convertible into common shares at 6.15:1 at the election of the holder and automatically converts upon consummation of an initial public offering. The Series A-2 Preferred has no voting rights other than matters subject to shareholder votes that would dilute or reduce the rights or privileges of the Series A-2 Preferred. Dividends accrue at 12% per annum on a cumulative basis and are payable in additional shares of Series A-2 Preferred. In addition, holders of the Series A-2 Preferred have liquidation preferences in the event of a dissolution or similar termination of the Company equal to $1.00 per share of Series A-2 Preferred plus any accrued and unpaid dividends. The Series A-2 Preferred holders have the right to require the Company to repurchase such shares if an Event of Default, as defined, occurs and is continuing subsequent to notice of such default. This mandatory redemption right is to be settled, in cash, at $1.00 per share of Series A-2 Preferred plus any accrued and unpaid dividends and expires upon consummation of an initial public offering of the Company's common stock with gross proceeds to the Company of at least $40 million. The redemption value of the Series A-1 Preferred is approximately $25.8 million at August 31, 2000.

On June 26, 2000, in connection with the $90 million term loan, the Company issued warrants to purchase mandatorily redeemable convertible Series C Preferred Stock ("Series C Preferred") at an aggregate price of $4.7 million. If the initial measurement date (defined as the earlier of (1) the date of an initial public offering whereby the Company receives at least $40 million or (2) June 26, 2002) occurs prior to June 26, 2002, the number of warrants issued is sufficient to represent a 1.20% interest in the Company, assuming full dilution. If the initial measurement date occurs after June 26, 2002, the number of warrants issued is sufficient to represent a 1.35% interest in the Company, assuming full dilution. In connection with the term loan, the Company issued the lenders the right to acquire Series D convertible preferred stock ("Series D Preferred") in exchange for $10 million of principal amount of the term loan. This right expired on September 9, 2000. If the right was exercised and the Series D Preferred was converted into common stock, the Company would have been required to issue 1,910,947 shares of common stock as of August 31, 2000. The Series D Preferred has terms substantially identical to the Series C Preferred.

On August 7, 2000, in connection with the $60 million term loan, the Company issued warrants to purchase Series C Preferred Stock at an aggregate price of $2.3 million. If the initial measurement date (defined as the earlier of (1) the date of an initial public offering whereby the Company receives at least $40 million or (2) August 7, 2002) occurs prior to August 7, 2002, the number of warrants issued is sufficient to represent a 0.80% interest in the Company, assuming full dilution. If the initial measurement date occurs after August 7, 2002, the number of warrants issued is sufficient to represent a 0.90% interest in the Company, assuming full dilution.

The Series C and D Preferred Stock is convertible into common shares at 6.15:1 at the election of the holder and automatically converts upon consummation of an initial public offering or exercise if after an initial public offering. The Series C and D have no voting rights other than matters subject to shareholder votes that would dilute or reduce the rights or privileges of the Series C and D Preferred. Dividends accrue at 12% per annum on a cumulative basis and are payable in additional shares of Series C and D Preferred. In addition, holders of the Series C and D Preferred have liquidation preferences in the event of a dissolution or termination of the Company equal to $1.00 per share of Series C and D Preferred plus any accrued and unpaid dividends. The Series C and D Preferred holders have the right to require the

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Company to repurchase such shares if an Event of Default, as defined, occurs and is continuing subsequent to notice of such default. This mandatory redemption right is to be settled, in cash, at $1.00 per share of Series C and D Preferred plus any accrued and unpaid dividends and expires upon consummation of an initial public offering and August 7, 2005, respectively. The warrants issued in connection with the $90 million term loan must be exercised on the earlier of twenty days after an initial public offering or June 26, 2005. The warrants issued in connection with the $60 million term loan must be exercised on the earlier of twenty days after an initial public offering or August 7, 2005. The fair value of the warrants was recognized as a reduction in the face value of the term loan based on the appraised fair value of approximately $9.2 million.

The Series A, A-1, A-2, C and D Preferred rank equal with respect to dividends and the liquidation preference and are senior to all other equity securities issued by the Company. The Series B Preferred is junior to the Series A, A-1, and A-2 Preferred but senior to all other equity securities issued by the Company. So long as the Series A, A-1, A-2, B, C and D Preferred are outstanding, no dividends may be declared or paid on junior securities and no junior securities may be redeemed, purchased, or otherwise acquired by the Company.

There were 54,228,893 shares of the Company's common stock issuable to the holders of the Series A, A-1, A-2, and B Preferred assuming conversion of all outstanding preferred shares including conversion of accrued dividends of 2,501,320 shares at August 31, 2000. In addition, 1,873,477 and 1,910,947 shares of the Company's Common Stock are issuable to the holders of the Series C and D Preferred, respectively, assuming the warrants or rights were fully exercised prior to the initial measurement date and the resulting Series C and D Preferred shares were fully converted to Common Stock.

Preferred stock dividends and accretion amounting to $15,245,439 at August 31, 2000 includes accrued dividends of $12,722,104 and accretion to the liquidation value for allocated equity issuance costs of $2,523,335.

10. Stockholders' Equity

Common Stock

In connection with the organization and initial capitalization, the Company issued 10 shares of Common Stock to its founder, Spacenet, on January 11, 2000 for $1.00 per share and, except for the additional shares issued to Spacenet, the following shares of common stock at $0.12 per share:

Date	Name	Shares
January 11, 2000	Spacenet, Inc	10
April 1, 2000	Spacenet, Inc	9,999,989
April 11, 2000	EchoStar Communications Corporation	6,450,022
April 11, 2000	ING Furman Selz Investments and affiliates	2,621,960
April 13, 2000	Microsoft Corporation and affiliates	6,450,022
May 3, 2000	Various investors	8,357,754

On April 1, 2000 the Company issued 9,999,989 shares of Common Stock to Spacenet in exchange for the exclusive North American rights for Spacenet and Gilat's high-speed satellite internet service for an initial term of five years for use in residential and small office/ home office market segment as well as management, employees, and technical expertise, and certain assets pursuant to the Services Agreement as discussed in Notes 1 and 3. Pursuant to Staff Accounting Bulletin No. 48, *Valuation of Assets Acquired*

From Promoters and Shareholders, the Company recorded the transfer at Spacenet's historical cost basis of $0.

The Common Stock issued to Spacenet and Microsoft may receive an annual dividend of $0.12 per share if the Company issues any equity security other than the Series A, A-1, A-2, and B

Preferred with dividend rights.

The Company has 110 million common shares authorized. As of August 31, 2000, excluding 15 million shares of common stock to be made available for the Company's stock option plan on January 1, 2001, the Company had 33.9 million shares of common stock issued and outstanding and reserved 58.1 million shares of common stock for issuance in connection with dividends and conversions of Series A, A-1, A-2, B, C and D convertible preferred stock and 8 million shares for stock options and warrants.

Common Stock Warrants

The Company issued warrants to purchase approximately 116,000 shares of the Company's Common Stock with an exercise price of $2.50 per share to certain third parties during the period from January 11, 2000 (inception) through August 31, 2000. These warrants generally vest over a four year period with the initial vesting occurring on the first anniversary of the grant date and on a quarterly basis thereafter. The Company accounts for such warrants pursuant to the provisions of SFAS No. 123 and recognizes related compensation expense ratably over the vesting period, as re-measured on each balance sheet date. The Company recorded non-cash deferred compensation aggregating $672,160 based on the fair value of such stock options at August 31, 2000 using a Black-Scholes option valuation model, which is being amortized on a straight line basis over the related vesting periods. There were no warrants exercisable at August 31, 2000.

Common Stock Options

Options to purchase the Company's Common Stock under its stock option plan have been granted to employees, directors and consultants of the Company, generally, at fair market value at the date of grant. The options generally become exercisable over periods of up to 4 years and expire 10 years from the date of grant. There are 23 million shares of common stock available for issuance pursuant to the stock option plan of which approximately 15 million shares become available for grant on January 1, 2001.

The Company determines the fair value of its common stock used in its accounting for stock option grants based on both arms length equity transactions and independent valuations obtained during the period from January 11, 2000 (inception) to August 31, 2000.

Certain employees qualify as common law employees as defined in FASB Interpretation No. 44, *Accounting for Certain Transactions Involving Stock Compensation — An Interpretation of APB Opinion No. 25* ("FIN No. 44"). Stock options issued to these employees are accounted for under APB 25. Certain stock options were granted to employees with an exercise price below the deemed fair value of the Company's Common Stock on the measurement date. The Company has recorded non-cash deferred compensation, based on the intrinsic value of such options aggregating $6,923,435, which is being amortized on a straight-line basis over the related vesting periods.

The Company granted 471,000 stock options to with an exercise price of $2.50 per share certain leased-employees who continue to vest in stock options they received from Gilat for services performed for Gilat prior to their employment with the Company. The stock options granted to these employees are accounted for under SFAS No. 123 in accordance FIN No. 44. The Company recorded non-cash deferred compensation aggregating $656,680 based on the fair value of such stock options at the measurement date

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using a Black-Scholes option valuation model, which is being amortized on a straight line basis over the related vesting periods.

Option activity is as follows:

	Shares	Weighted-Average Exercise Price
Outstanding at January 11, 2000 (inception)	—	$ —
Granted:		
May 2000	3,545,220	2.50
June 2000	173,000	2.50
July 2000	90,000	2.50
August 2000	1,646,500	2.50
Total granted	5,454,720	
Exercised	—	—
Cancelled	5,500	—
Outstanding at August 31, 2000	5,449,220	2.50

Information about stock options outstanding at August 31, 2000 is as follows:

Range of Exercise Prices	Options Outstanding	Weighted-Average Remaining Contractual Life	Weighted Average Exercise Price	Options Exercisable	Weighted-Average Exercise Price
2.50	5,449,220	3.6 years	2.50	—	2.50

The Black-Scholes option valuation model was developed for use in estimating the fair value of traded options that have no vesting restrictions and are fully transferable. In addition, option valuation models require the input of highly subjective assumptions, including the expected stock price volatility. Because the Company's employee stock options have characteristics significantly different from those of traded options, and because changes in the subjective input assumptions can materially affect the fair value estimate, in management's opinion, the existing models do not necessarily provide a reliable single measure of the fair value of its employee stock options. For purposes of the pro forma disclosure, the estimated fair value of the options is amortized to expense over the options' vesting period.

The Company's net loss attributable to common shareholders would have been approximately $82.7 million, or $(4.09) per share, during the period from January 11, 2000 (inception) to August 31, 2000 had compensation expense for the Company's stock option plans been determined based upon the fair value at the grant dates for awards under the plans consistent with the methodology prescribed under SFAS No. 123. The fair value of each option grant is estimated on the date of grant using the Black-Scholes option pricing model with the following assumptions: volatility of 75%; dividend yield of 0%; risk-free interest rate of 6.0%; and expected life of the option term of 4 years. The effect of applying SFAS No. 123 on the net loss is not necessarily representative of the effects on reported net income (loss) for future years due to, among other things, (1) the vesting period of the stock options and (2) the fair value of additional stock options in future years.

Gilat issued stock options related to its common stock to certain StarBand executives. These stock options are being accounted for under EITF Issue No. 00-12 "Accounting by an Investor for Stock Based Compensation Granted to Employees of Equity Method Investees".

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Reserve for Issuance

The Company had 8 million shares of common stock reserved for issuance pursuant to the stock option plan at August 31, 2000. After giving effect to options granted through August 31, 2000, there were 2,550,780 shares of Common Stock reserved and available for future issuances upon exercise of outstanding and unissued stock options, warrants, and preferred stock at August 31, 2000 before giving effect to the 15 million shares of common stock available for grant commencing January 1, 2001 as authorized by the Company's Board of Directors on September 19, 2000.

11. Employee Benefit Plan

401(k) Plan

The Company's employees participate in a defined contribution 401(k) retirement plan sponsored by Spacenet. The plan allows employees of the Company to make pre-tax contributions to the plan, subject to a statutorily prescribed annual limit. Each participant is fully vested in his or her contributions and the investment earnings. The plan also provides for the Company to match the employees' contributions up to a stated limit. The Company's contributions vest over 3 years. During the period from January 11, 2000 (inception) through August 31, 2000, the Company contributed $33,675 to the plan on behalf of employees.

12. Commitments and Contingencies

Leases

The Company entered into an agreement with Spacenet to assign the Company Spacenet's rights in a non-preemptible transponder capacity service lease on the GE-4 Satellite ("GE-4") in 2000. The terms of service provide that transponders be placed in service on January 17, 2000 extending through the earlier of the end-of-life or replacement date, the date the satellite or transponder becomes a satellite or transponder failure, or January 16, 2005. Significant terms of the operating lease include that the Company pay a $7.2 million reservation fee and monthly payments of approximately $0.15 million per transponder. Rental expense under the GE-4 capacity service lease was approximately $3.1 million during the period from January 11, 2000 (inception) through August 31, 2000.

The Company entered into a non-preemptible transponder capacity service lease on the Telstar 7 Satellite ("Telstar 7") on August 31, 2000. The terms of service provide that transponders be placed in service on September 1, 2000, January 1, 2001, and April 1, 2001. The Company's rights to the exclusive use of the transponders extend through December 31, 2007. The Company has the right to extend the terms of service for any or all transponders through the anticipated end-of life of Telstar 7, which is currently anticipated to be October 31, 2013 in incremental two-year periods or a single extension commencing on January 1, 2008 through the end-of life. Significant terms of the operating lease include that the Company pay $0.8 million upon contract signing for three months of service, a reservation fee of $2.3 million on December 1, 2000, providing an irrevocable letter of credit in favor of the lessor or a cash security deposit of approximately $26.3 million on December 1, 2000, and monthly payments per transponder.

The Company leases office space and various office and computer equipment under noncancelable operating lease agreements. Rental expense during the period from January 11, 2000 (inception) to August 31, 2000 was approximately $391,000.

STARBAND COMMUNICATIONS INC.
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NOTES TO FINANCIAL STATEMENTS — (Continued)

Minimum future lease payments under operating leases, including transponder capacity service, at August 31, 2000 are summarized as follows:

	Operating Leases
2001	$ 28,970,000
2002	36,638,000
2003	36,590,000
2004	36,590,000
2005	31,475,000
Thereafter	57,190,000
	$227,453,000

Contingencies

On or about July 26, 2000, Globecomm Systems, Inc. ("Globecomm") commenced a lawsuit against us in the Eastern District of New York alleging the willful infringement of United States Patent No. 5,912,883. Globecomm is seeking an award for an undisclosed sum of money. The Globecomm patent is directed through an earth-orbiting satellite. The system claimed in the patent includes a central hub gateway server including a plurality of modems. In particular, each of the modems is assigned to receive and transmit signals in a specified data channel. There is also a means for modulating the data signals from all of the modems to a satellite frequency band. The system claimed in the Globecomm patent employs one data channel per modem, which is commonly referred to as a single carrier per channel technology. The Company has not yet filed an answer to the complaint of Globecomm. The Company intends to answer the complaint and vigorously contest the claims made by Globecomm in due course. The outcome of this lawsuit is inherently uncertain and management is unable to evaluate the chances of the claim or its effect on the Company.

In addition, on May 8, 2000, Hughes Electronics Corporation ("Hughes") commenced a lawsuit against Gilat and Spacenet in the District of Maryland, Southern Division, concerning U.S. Patent Nos. 5,699,384; 5,995,725; 5,995,726; and 6,016,388. The Company is not a party to the lawsuit, but a ruling against Gilat or Spacenet could significantly harm the Company's business because it uses license technology from Gilat/ Spacenet that forms part of Hughes claim. In particular, U.S. Patent No. 5,699,384 is related to personal computer based receiver cards that the Company uses as part of its service offering to customers. The Company may not be able to continue to use the technology if Hughes prevails on its claim regarding this technology. Gilat and Spacenet have filed motions for partial summary judgment on the issue of patent claim construction and the Court has scheduled a hearing on these motions for November 20, 2000. The outcome of this lawsuit is inherently uncertain and management is unable to evaluate the chances of the claim or its effect on the Company.

The Company does not currently have insurance that would indemnify it for any liability that may be imposed in connection with the legal actions described above. Accordingly, if the final disposition of these lawsuits is in favor of the plaintiff, the related liability could result in a material adverse effect on the Company's financial position and results of operations.

The Company has entered into employment agreements with certain members of senior management and other key employees. These agreements specify minimum annual salaries as well as performance bonus amounts and criteria. In addition, these executives have certain severance benefits, which would have a negative impact on the Company's results of operations if such executives were terminated under certain circumstances.

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STARBAND COMMUNICATIONS INC.
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NOTES TO FINANCIAL STATEMENTS — (Continued)

13. Subsequent Events

During September 2000, the Board of Directors approved the payment of $4 million to Gilat for its assistance in obtaining debt and equity for the Company. This payment has been allocated on a pro-rata basis between debt and equity securities issued as reductions in additional capital and additional deferred debt issuance costs, respectively, as of August 31, 2000. The deferred debt issuance costs have been recognized as a component of other assets and are amortized over the period of the term loan as an additional component of interest expense using the effective interest method.

The Company's Board of Directors authorized the Company to file an initial registration statement on Form S-1 to register shares of the Company's common stock for an initial public offering. The ultimate terms and conditions of such transaction, if and when consummated, will be determined based on market conditions and other variables not within the control of the Company and are not estimable at this time.

14. Pro Forma Adjustments (Unaudited)

The Company's Preferred Stock will automatically convert into Common Stock at consummation of an initial public offering resulting in aggregate proceeds to the Company of at least $40 million. The pro forma balance sheet at August 31, 2000 reflects the conversion of all classes of the Company's Preferred Stock into common stock as of that date. The pro forma loss per share reflects the conversion of all classes of the Company's outstanding convertible preferred stock as of the respective date of issuance.

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INSIDE BACK COVER

TEXT ON STARBAND INDIAN NATIONS PROJECT FOR PROSPECTUS

The promise of StarBand is greater than just high-speed Internet access. StarBand is already changing the lives of thousands of Native Americans in the Southwest, impacting education, law enforcement, and quality of life.

"This is a turning point for our community." The Havasupai Indians hope that some of their tribal members will get online college degrees, remaining on the reservation to teach the next generation.

Sally Tisoult, Director of the Havasupai Head Start School
[Picture of Head Start School and Kids]

"Yesterday I was thinking that technology was so far into the future, but today it's right here. We have it. Now, we can be part of the international as well as the national community."

[Photo of Ben Jones, Director of Communications Services, Navajo Nation Government]

"These Indian Nations are jumping generations of technology in a couple of hours and into the 21st century. They have gone from dial-up service that didn't work very well to StarBand's unique, high-speed service."

Ed Groenhout, Vice President for Strategic Initiatives at Northern Arizona University

[Photo of install in Grand Canyon]

StarBand connects its subscribers, from the Grand Canyon to Silicon Alley, to new experiences, communities, and opportunities. Our first-to-market service is a compelling solution for users nationwide who need a highly reliable, high-speed connection to the Internet today.

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Through and including , 2000 (the 25th day after the date of this prospectus), all dealers effecting transactions in these securities, whether or not participating in this offering, may be required to deliver a prospectus. This is in addition to the dealers' obligation to deliver a prospectus when acting as underwriters and with respect to their unsold allotments or subscriptions.

Shares

[STARBAND LOGO]

Common Stock

PROSPECTUS

Merrill Lynch & Co.